

BANKING CONDUCT SUPERVISION REPORT

2014



BANCO DE PORTUGAL
EUROSYSTEM



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Note from the Governor

Since 2008, when banking conduct supervision was introduced into the Portuguese legal system, Banco de Portugal has been strengthening the framework of rules and values concerning transparency in contracting banking products: deposits, credit and payment instruments. The financial education of bank customers has also been a concern and an investment, because institutions' compliance with their duties of information is not always enough to ensure that customers understand the extent of the contracts.

The last few years have been marked by global economic and financial crisis, in part arising from over-indebtedness. The deterioration of financial conditions caused by the crisis has itself led the legislator to redouble the attention to credit agreements. There is now a dense regulatory framework governing responsible credit concession, aiming to ensure consumers enter into credit agreements that are appropriate for their profile, in an informed and conscientious way. The protection of borrowers' interests during the execution of credit agreements, when compliance is difficult, when in arrears or foreclosure was also strengthened.

Several economic and financial behavioural studies have shown that people tend to overestimate their ability to understand financial products. Savers in particular tend to look at return and under assess associated risks, in the belief that eventual losses will be assumed by third parties. These studies also show that, when making investments in financial products, people sign forms without full awareness of their content, due to inertia.

There are no high returns without associated risk. This warning should be transmitted clearly at the time of entering into the contract. Savers and investors must be made aware that they should only take on the risks that they can understand and manage.

Banco de Portugal, together with the Portuguese Securities Market Commission (CMVM) and the Portuguese Insurance and Pension Funds Supervisory Authority (ASF), has developed financial training programs within the National Plan for Financial Education, aiming to change attitudes and behaviours and improve financial knowledge among the general public. However, financial education produces results mainly in the medium to long term.

One area that may require new regulation is the way of selling savings products. There are good reasons to display the traditional banking products (deposits, credit and payment instruments) separately from the other investment products, so that their different nature may be easily perceived by the general public. This 'separation of display' could involve the clear separation of the commercial spaces used for selling deposits and investment products in the credit institutions' branches.

After institutions' transparency towards their customers has topped the agenda of banking conduct supervision, now the focus should move towards more intrusive action over the institutions' internal procedures for creating, approving and selling retail banking products. Effective mechanisms must be designed to ensure that the institutions take into account consumers' interests, goals and characteristics and that they adopt a culture of compliance with the spirit and not strictly the letter of the law.

Financial regulation is a work-in-progress, and by its very nature is not complete. The list of agents in the financial system is long, their range of activities is complex and their geographical location is widely dispersed. Furthermore, financial innovation is constant and each day new agents, channels and innovative products arise. Malpractice is detected through market supervision and, in reaction, there is an effort to design mechanisms to prevent, discover and effectively penalise that malpractice, thereby maintaining confidence and equilibrium in the financial system.

The Governor

Carlos da Silva Costa

Executive summary

In the Banking Conduct Supervision Report, Banco de Portugal:

- Analyses developments in the legal framework governing retail banking markets (Chapter I);
- Assesses the impact of the implementation of arrears regimes (Chapter II);
- Presents financial literacy and education activities developed by Banco de Portugal within the scope of the National Plan for Financial Education (Chapter III);
- Describes its supervisory activities of retail banking markets, including sanctions (Chapter IV);
- Summarises legal and regulatory initiatives, activities on the international agenda and international cooperation activities in which Banco de Portugal is involved (Annex).

Developments in the legal framework governing retail banking markets

In 2014 Banco de Portugal was involved in the preparation and implementation of a number of regulatory initiatives at national and European level, which enhance the current legal framework.

Regarding consumer credit, the Notice of Banco de Portugal issued in December 2014 will force credit institutions to comply with information duties for the duration of the agreements, namely by issuing regular statements. Customers may thus monitor developments in the agreements they have signed, similarly to what already happened in housing credit or deposit accounts. This Notice will enter into force in July 2015.

As regards deposit accounts, Banco de Portugal once again supported the promotion of the basic bank accounts regime and issued recommendations on the simplification and standardisation of fees associated with deposit accounts.

Banco de Portugal recommended that institutions offer a standardised deposit account (base account) whose servicing fee would cover the provision of payment instruments for account transactions. It also considered as inappropriate the business practice of changing the servicing fee amount based on the average account balance, due to the fact that a fee corresponds to a payment for services supplied.

Banco de Portugal participated in important European regulatory initiatives, published in 2014, in particular the directives on mortgage credit and payment accounts, which will enter into force in 2016. Some of these initiatives, notably those involving the definition of information duties, are addressed to markets and products on which Portugal already has quite a developed legal and regulatory framework. Banco de Portugal has also participated in the European Banking Authority's activities involving new areas of regulation with more intrusive action and the trading of new products and/or use of new channels. Key work included a reflection about the regulation of payment services over the internet, the use of virtual currencies and alternative forms of financing such as crowdfunding.

Assessment of arrears regimes

Around two years after the launch of the **general regime**, at the end of 2014 Banco de Portugal held a new consultation process to assess its implementation. Credit institutions, entities involved in assistance for indebted consumers and other interested parties were heard.

Overall, credit institutions and consumer protection associations considered that the implementation of the general regime had a positive impact on how credit institutions detect and monitor bank customers at risk of arrears, under the Pre-arrears Action Plan (PRAP) and seek, in conjunction with their customers, to settle arrears on credit agreements under the Out-of-court Arrears Settlement Procedure (OASP).

Credit institutions consulted reported that settlement agreements signed under the OASP generally allow credit agreements not to return to arrears, although the success of the agreed measures depends on the maintenance of the professional and financial situation of households and expenses taken on with other credit institutions. In addition, settlement agreements also occur outside the scope of the OASP, and thus data on agreements signed under this proceeding do not fully reflect the results of the negotiation developed by credit institutions with customers in arrears. Consumer protection associations suggested that stricter rules should be defined in the negotiation process between credit institutions and customers during the OASP.

Banco de Portugal has been monitoring implementation of arrears regimes, notably of agreements in the OASP and requests for access to the extraordinary regime, through information reported by credit institutions.

In 2014 credit institutions initiated around 663,000 procedures under the OASP on approximately 505,000 credit agreements, involving a total outstanding amount of around €5.7 billion and a default ratio of 5.1 per cent. Of the credit agreements integrated in the OASP, 83 per cent were under the scope of the consumer credit regime and 17 per cent were mortgage credit agreements. The share of procedures under the OASP concluded with the settlement of arrears was 60.2 per cent in mortgage credit and 44.7 per cent in consumer credit.

In 2014 bank customers filed 622 requests for access to the extraordinary regime, 66 per cent less than in 2013. However, since the entry into force of the changes to the extraordinary regime on 24 September, there has been an increase in the monthly number of requests filed by bank customers. The changes introduced have made the conditions for bank customer access to the regime more flexible and incorporated good practice approved by the Assessment Committee and communicated to the market by Banco de Portugal.

In 2014, institutions denied 492 requests for access to the extraordinary regime, mostly due to lack of evidence demonstrating access conditions and to non-completion of the access conditions regarding customers' household income. Institutions approved 133 requests for access, which accounted for around €7 million of settled debt and around €700,000 in credit overdue. Of the 155 extraordinary regime proceedings concluded, around 63 per cent led to an agreement between the parties.

In its inspections, Banco de Portugal paid special attention to the implementation of arrears regimes, conducting a total of 61 inspections, mostly at the premises of credit institutions, of which 41 were on-site and 15 were of the central services.

Supervisory activities

In 2014 monitoring of information leaflets on indexed and dual deposits was particularly intense, due to the growth of this market. Over the year Banco de Portugal assessed the conformity of 219 information leaflets, 38 per cent more than in 2013, and checked calculation of the return on 109 indexed deposits and 22 tranches of dual deposits that matured in 2014.

Banco de Portugal analysed 6,556 advertising campaigns on banking products and services and issued 67 recommendations and specific orders in that area.

It also assessed compliance with maximum interest rates in all new consumer credit agreements (around 1.4 million agreements).

In addition, 1,332 price lists reported by credit institutions were monitored, and Banco de Portugal requested changes to 291 fees leaflets.

In 2014 there was a considerable increase (32 per cent more) in inspections conducted at the branches of credit institutions (on-site and central services), as a result of the nature of the subjects inspected, notably arrears regimes.

In addition to monitoring the arrears regimes and the arrears interest on banking transactions regime, Banco de Portugal also prioritised the monitoring of basic bank accounts.

There was also a considerable increase in on-site inspections of institutions on matters related to payment accounts, time deposits, price lists and compliance with the rules of the Complaints Book system.

In 2014 Banco de Portugal received 14,157 complaints from bank customers against credit institutions, 21 per cent less than in the previous year. This trend was observed in most banking products, except for direct debits, with the completion of the process of migration to SEPA.

The reduction of the number of complaints reflected a decline in complaints about the charging of fees and complaints on outstanding amounts in consumer credit products.

In the wake of its monitoring tasks, Banco de Portugal issued 770 recommendations and specific orders, requiring 75 institutions to correct irregularities detected.

As part of its banking conduct supervision tasks, Banco de Portugal initiated 64 administrative proceedings against 25 institutions, of which 28 complied with the arrears regimes. These proceedings resulted mainly from the audit of an analysis of bank customer complaints.

Banco de Portugal also concluded 27 administrative proceedings and imposed fines to an amount of around €500,000.

Financial literacy and education initiatives

The strategy to introduce financial education in schools under the **National Plan for Financial Education** was continued, with the start of teacher training and preliminary work for the production of educational materials. The third *Todos Contam* ('Everybody Counts') Competition was held, with the purpose of rewarding the best financial education projects to be implemented in schools, and Financial Education Day was celebrated, this year devoted to the importance of financial education in the support of entrepreneurship.

On the Financial Education Day, the National Plan for Financial Education's e-learning platform was presented, which is expected to be launched in 2015. The platform will allow initiatives to reach a greater number of people and have a wider geographical coverage.

Activities developed by the Plan within the scope of financial education in schools were acknowledged in 2014 by Child and Youth Finance International, which distinguished Portugal with the 2014 Country Award for Europe.

In addition to activities developed under the National Plan for Financial Education, Banco de Portugal promotes and participates on a regular basis in **training courses** on banking products and services. In 2014 Banco de Portugal started to involve its regional network in these training courses to increase its geographical coverage and ensure that financial education reaches the highest number of target groups as possible. Most courses aimed to acquaint banking customers with the regimes for the prevention and settlement of arrears, the new arrears interest on banking transactions regime and the legal framework of basic bank accounts.

The "Portal do Cliente Bancário" (**Bank Customer Website**) is the main channel used by Banco de Portugal to release financial information to the public. On this website, Banco de Portugal now also releases information allowing bank customers to compare servicing fees of basic bank accounts and base accounts applied by the credit institutions. With the purpose of releasing information on the consumer credit market in a fast and transparent manner, information regarding the new consumer credit agreements is now released on the website on a monthly basis.

Banking conduct supervision in numbers – 2014

Arrears regime monitoring:

- Information analysed on 662,635 procedures under the OASP on housing credit and consumer credit agreements;
- Information analysed on 622 requests for access to the extraordinary regime;
- 1,126 complaints received on issues pertaining to the arrears regimes, 27 of which on the extraordinary regime;
- 102 information requests on arrears received from bank customers, 11 of which on the extraordinary regime;
- 16 inspections of the general regime of 8 institutions, 11 of which of the central services and 5 off-site;
- 45 inspections of the extraordinary regime of 15 institutions, 41 of which on-site and 4 of the central services.

Systematic monitoring:

- Monitored 1,332 price lists (764 fees and expenses leaflets and 568 interest rate leaflets) of 95 institutions;
- Analysed 6,556 advertising campaigns of 54 institutions;
- Conducted prior inspections of 219 information leaflets on indexed and dual deposits offered by 12 institutions;
- Checked the calculation of returns on 131 matured indexed and dual deposits;
- Assessed compliance with maximum rates, based on information reported by 55 credit institutions on 1,377,184 consumer credit agreements.

Inspections:

- 303 inspections of the price lists of 96 institutions, of which 201 off-site and 102 on-site;
- 130 inspections of payment accounts and instruments of 60 institutions, 68 of which off-site, 59 on-site and 3 of the central services;

- 125 inspections of consumer credit offered by 56 institutions, 64 of which off-site, 59 on-site and 2 of the central services;
- 99 on-site inspections of the Complaints Book of 21 institutions;
- 59 inspections of simple time deposits of 56 institutions, 56 of which on-site and 3 off-site;
- 50 inspections of basic bank accounts of 10 institutions, 48 of which on-site and 2 off-site;
- 30 inspections of the arrears interest on banking transactions regime of 11 institutions, 19 of which off-site and 11 of the central services;
- 11 inspections of mortgage credit of 10 institutions, 10 of which off-site and 1 on-site.

Complaints management:

- 14,157 complaints received, a monthly average of 1,180;
- 67 per cent of complaints closed with no signs of breach.

Information requests:

- 2,644 information requests received from bank customers, a monthly average of 220.

Correction of irregularities and sanctions:

- 770 specific orders issued requiring 75 institutions to correct irregularities, of which:
 - 170 on the implementation of the arrears regimes;
 - 19 on the implementation of the legal framework of basic bank accounts.
- Opening of 64 administrative proceedings against 25 institutions for breach of rules;
- Around €500,000 in fines.

